

expense attributable to the same activity.

(ii) A liability is material if it is material for financial statement purposes under generally accepted accounting principles.

(iii) A liability that is immaterial for financial statement purposes under generally accepted accounting principles may be material for purposes of this paragraph (b).

(5) *Matching requirement.* (i) In determining whether the matching requirement of paragraph (b)(1)(iv)(B) of this section is satisfied, generally accepted accounting principles are an important factor, but are not dispositive.

(ii) In the case of a liability described in paragraph (g)(3) (rebates and refunds), paragraph (g)(4) (awards, prizes, and jackpots), paragraph (g)(5) (insurance, warranty, and service contracts), paragraph (g)(6) (taxes), or paragraph (h) (continuing fees under the Nuclear Waste Policy Act of 1982) of § 1.461-4, the matching requirement of paragraph (b)(1)(iv)(B) of this section shall be deemed satisfied.

(c) *Types of liabilities not eligible for treatment under the recurring item exception.* The recurring item exception does not apply to any liability of a taxpayer described in paragraph (e) (interest), paragraph (g)(2) (workers compensation, tort, breach of contract, and violation of law), or paragraph (g)(7) (other liabilities) of § 1.461-4. Moreover, the recurring item exception does not apply to any liability incurred by a tax shelter, as defined in section 461(i) and § 1.448-1T(b).

(d) *Time and manner of adopting the recurring item exception—(1) In general.* The recurring item exception is a method of accounting that must be consistently applied with respect to a type of item, or for all items, from one taxable year to the next in order to clearly reflect income. A taxpayer is permitted to adopt the recurring item exception as part of its method of accounting for any type of item for the first taxable year in which that type of item is incurred. Except as otherwise provided, the rules of section 446(e) and § 1.446-1(e) apply to changes to or from the recurring item exception as a method of accounting. For taxable years ending before April 7, 1995, see

Q&A-7 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995) for rules concerning the time and manner of adopting the recurring item exception for taxable years that include July 19, 1984. For purposes of this section, items are to be classified by type in a manner that results in classifications that are no less inclusive than the classifications of production costs provided in the full-absorption regulations of § 1.471-11(b) and (c), whether or not the taxpayer is required to maintain inventories.

(2) *Change to the recurring item exception method for the first taxable year beginning after December 31, 1991—(i) In general.* For the first taxable year beginning after December 31, 1991, a taxpayer is granted the consent of the Commissioner to change to the recurring item exception method of accounting. A taxpayer is also granted the consent of the Commissioner to expand or modify its use of the recurring item exception method for the first taxable year beginning after December 31, 1991. For each trade or business for which a taxpayer elects to use the recurring item exception method, the taxpayer must use the same method of change (cut-off or full-year change) it is using for that trade or business under § 1.461-4(m). For taxable year ending before April 7, 1995, see Q&A-11 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995) for an explanation of how amounts are taken into account under the cut-off method (except that, for purposes of this paragraph (d)(2), the change applies to all amounts otherwise incurred on or after the first day of the first taxable year beginning after December 31, 1991). For taxable years ending before April 7, 1995, see Q&A-6 of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995) for an explanation of how amounts are taken into account under the full-year change method (except that the change in method occurs on the first day of the first taxable year beginning after December 31, 1991). For taxable years ending before April 7, 1995, the full-year change in method may result in a section 481(a) adjustment that must be taken into account in the manner described in Q&A-8 and Q&A-9 of § 1.461-7T (as it appears in 26

CFR part 1 revised April 1, 1995) (except that the taxable year of change is the first taxable year beginning after December 31, 1991).

(ii) *Manner of changing to the recurring item exception method.* For the first taxable year beginning after December 31, 1991, a taxpayer may change to the recurring item exception method by accounting for the item on its timely filed original return for such taxable year (including extensions). For taxable years ending before April 7, 1995, the automatic consent of the Commissioner is limited to those items accounted for under the recurring item exception method on the timely filed return, unless the taxpayer indicates a wider scope of change by filing the statement provided in Q&A-7(b)(2) of § 1.461-7T (as it appears in 26 CFR part 1 revised April 1, 1995).

(3) *Retroactive change to the recurring item exception method.* For the first taxable year beginning after December 31, 1989, or December 31, 1990, a taxpayer is granted consent of the Commissioner to change to the recurring item exception method of accounting, provided the taxpayer complies with paragraph (d)(2) of this section on either the original return for such year or on an amended return for such year filed on or before October 7, 1991. For this purpose the effective date is the first day of the first taxable year beginning after December 31, 1989, or the first day of the first taxable year beginning after December 31, 1990. A taxpayer is also granted the consent of the Commissioner to expand or modify its use of the recurring item exception method for the first taxable year beginning after December 31, 1989, December 31, 1990, or December 31, 1991.

(e) *Examples.* The following examples illustrate the principles of this section:

Example 1. Requirements for use of the recurring item exception. (i) Y corporation, a calendar year, accrual method taxpayer, manufactures and distributes video cassette recorders. Y timely files its federal income tax return for each taxable year on the extended due date for the return (September 15, of the following taxable year). Y offers to refund the price of a recorder to a purchaser not satisfied with the recorder. During 1992, 100 purchasers request a refund of the \$500 purchase price. Y refunds \$30,000 on or before

September 15, 1993, and the remaining \$20,000 after such date but before the end of 1993.

(ii) Under paragraph (g)(3) of § 1.461-4, economic performance with respect to \$30,000 of the refund liability occurs on September 15, 1993. Assume the refund is deductible (or allowable as an adjustment to gross receipts or cost of goods sold) when incurred. If Y does not adopt the recurring item exception with respect to rebates and refunds, the \$30,000 refund is incurred by Y for the 1993 taxable year. However, if Y has properly adopted the recurring item exception method of accounting under this section, and as of December 31, 1992, all events have occurred that determine the fact of the liability for the \$30,000 refund, Y incurs that amount for the 1992 taxable year. Because economic performance (payment) with respect to the remaining \$20,000 occurs after September 15, 1993 (more than 8½ months after the end of 1992), that amount is not eligible for recurring item treatment under this section. Thus, the \$20,000 amount is not incurred by Y until the 1993 taxable year.

Example 2. Requirements for use of the recurring item exception; amended returns. The facts are the same as in *Example 2*, except that Y files its income tax return for 1992 on March 15, 1993, and Y does not refund the price of any recorder before that date. Under paragraph (b)(1) of this section, the refund liability is not eligible for the recurring item exception because economic performance with respect to the refund does not occur before Y files a return for the taxable year for which the item would have been incurred under the exception. However, since economic performance occurs within 8½ months after 1992, Y may file an amended return claiming the \$30,000 as incurred for its 1992 taxable year (see paragraph (b)(2) of this section).

[T.D. 8408, 57 FR 12427, Apr. 10, 1992, as amended by T.D. 8593, 60 FR 18743, Apr. 13, 1995]

§ 1.461-6 Economic performance when certain liabilities are assigned or are extinguished by the establishment of a fund.

(a) *Qualified assignments of certain personal injury liabilities under section 130.* In the case of a qualified assignment (within the meaning of section 130(c)), economic performance occurs as a taxpayer-assignor makes payments that are excludible from the income of the assignee under section 130(a).

(b) *Section 468B.* Economic performance occurs as a taxpayer makes qualified payments to a designated settlement fund under section 468B, relating to special rules for designated settlement funds.